

DIW Applied Micro Seminar

Policy Uncertainty and Social Security Reform

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Abstract:

This paper estimates the effect of uncertainty about pension reform in Europe both before and after the financial crisis. Using data on subjective beliefs from SHARE, we provide evidence of considerable uncertainty about the future path of pension provision. This uncertainty exists along multiple dimensions — such as the generosity of benefits and changes to pensionable age — and beliefs about future reforms are highly heterogeneous. To assess the effects of this uncertainty we estimate a rich life-cycle model of saving, labour supply and pension wealth accumulation. A new and important contribution is that the model allows for the evolution of subjective beliefs. We find that, across the whole population, the different types of uncertainty have moderate effects, even during (or after) the financial crisis, and even allowing for high levels of risk aversion. Some subgroups of the population, however, face higher welfare costs of uncertainty, particularly those approaching retirement in unemployment. Conversely, for those in work, pension uncertainty is overshadowed by (current) income uncertainty and is reduced by flexibility about retirement choice. We show that, within different types of reform, uncertainty about benefit generosity is more costly than uncertainty about pensionable age. Finally, we assess the consequences of belief heterogeneity."